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TESTIMONY OF MICHAEL E. MINAHAN, PRESIDENT

FEDERAL MANAGERS ASSOCIATION

BEFORE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

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First, we would like to commend your efforts and the efforts of your staff in designing a new, supplemental retirement system. We recognize the amount of work it entails. We believe that the basic design of the plan, a three-tiered system, is sound. We do wish to offer some suggestions for improvement, however.

We note that upon introducing your bill into the Congressional Record on July 30, you stated, "According to experts, the ideal retirement plan provides benefits that will maintain the standard of living of a career employee into retirement." Although you indicated that the Stevens-Roth bill provides such a benefit, we must respectfully disagree.

Designing a retirement system is a complex assignment. It is made even more complex here because there will be two different plans in one workforce. We would note here that our members are adamantly opposed to any changes in the current retirement system.

We are pleased to see that the basic pension is a defined benefit. In addition, we believe that the three-tiered plan provides the best method for moving toward equal benefits for all workers. In a manager's case, he or she has already been penalized in salary growth in the Federal government. Pay caps and a merit pay system with no pools of money for raises has lessened the value of the Federal manager's pay. To penalize this person further by offering him or her a lower percentage of replacement income at retirement would cause heightened frustrations. The add-on plan appears to do this.

I. PLAN DESIGN

Social Security "Tilt"

The tilt inherent in Social Security, whereby lower-income employees have a larger percentage of their income replaced by Social Security than do higher-income employees, is an important item for FMA. While we certainly agree that such a distribution is a noble social goal, most of our members are at the higher end of the salary scale and an equitable solution must be found to offer them a reasonable replacement income. We must point out that what we are designing is a retirement system, not a social welfare program.

In considering the income distribution issue, the two types of plans often mentioned are offset plans and add-on plans. Our membership does not favor an add-on plan, such as in your bill, because add-ons follow the tilt of Social Security. Whereas in our current system, workers at all levels of income receive the same percentage of income at retirement, with an add-on our members will receive a smaller percentage of their income than lower-income workers.

What FMA would really like is a 100% offset plan which would eliminate the tilt. Unfortunately, there are major problems with such a plan, one of which is that it would be illegal in the private sector. Another is that it would cost more than the current system. After much soul-searching, we are ready to support an offset plan of at least 50% and urge you to consider this change.

This will relieve some of the tilt in Social Security and still enable us to stay within the cost parameters of the current system. Most of the plans in private industry are 50% offset plans.

If we do end up with an add-on plan, some accommodation must be made for higher-income employees. Such an accommodation would be a capital accumulation plan.

Capital Accumulation Plan (CAP)

The CAP as defined in your bill offers a good opportunity for higher grade employees to achieve a reasonable amount of replacement income when they retire, if they have 10% of their income to invest. Because the defined benefit part of your plan is an add-on, it is especially important that the CAP offers a chance for significant personal savings. The options available under the plan for investment and disbursement of the funds allow Federal employees greater discretion in planning their retirement. In addition, we believe there is a psychological benefit to depoliticizing at least some of the retirement benefits afforded Federal employees.

We understand that the Administration is again proposing the elimination of 401(k)s. Should this happen, it appears unlikely that your bill will be allowed to retain the CAPs for Federal workers. If the 401(k) is eliminated, we would urge that you reconsider and accept the notion of explicitly integrating this plan so that retirement income is equally distributed to all salary levels.

II. FEATURES OF THE PLAN

One of the most important goals in the new system should be to make it as similar to the old system as possible. The ideal would be two people working side by side, one in the current system and one in the new system, with the same benefits. With the inclusion of Social Security into the system, it is not possible to attain such a goal. Even so, we would like to suggest some changes in the features of your plan that will lessen the dissimilarity.

- Age - In the current system, employees are eligible to retire at 55 years with 30 years of service with full benefits. Your plan allows retirement at that age with 30 years of service and a 2% reduction for every year under age 62. This means a difference of 53% of income replaced at retirement in the current system compared with a 23%-38% replacement rate in the new system, depending on how much income one has available to put into the CAP. We believe that an employee who gives his or her entire career to the Federal Government is certainly worthy of retiring at 55 with a reasonable expectation of equitable benefits. We believe that it's important to remember that the retirement system is only a part of the total compensation package of the Federal employee. A good retirement system is what has helped us retain top-notch managers. Please keep in mind that the Federal manager has been repeatedly penalized in salary growth.

- Cost-of-living adjustment - Federal employees have worked hard to retain a full COLA for annuitants in the current retirement system. We have fought hard because it is untenable to allow a retiree's income to shrink each year at a time in one's life when market forces have the most impact.

- Salary base - The current system uses the high three years of salary in its formula for the defined benefit. Your plan uses the high five years. We see no reason for such a change, and in the interests of equity, urge a high three year salary base. Further, because the accrual rate (1%) is so much lower than in the current system, it is important that the salary base be as accurate a reflection of salary as possible. A three-year span more closely relates the basic rate to salary.

- Survivor and disability benefits - While we understand the need to contain costs in this atmosphere of concern about Federal expenditures, we submit that the survivor and disability benefits in your plan could benefit by some additional features. For instance, we must insist on a survivor benefit that is payable immediately, regardless of whether the employee was eligible to retire or not. In addition, actuarially reducing the survivor's benefit to the extent that your plan does, is about the same as offering no benefit at all.

- Cost - The introduction of Social Security into the compensation of Federal employment means that some benefit dollars currently spent on retirement benefits will flow to benefit categories not paid under the current system. To reduce the retirement benefit even more by reducing the overall cost of the system would be unfair. We urge you to consider the addition of benefits as we have outlined. It is possible to have a retirement plan that more closely approximates the current one. For the benefit of assuring a continued high quality workforce, it is essential.

- Special categories of employees - Many of our members are air traffic control supervisors. The changes in the Stevens-Roth bill for these workers are even harsher in their effect than for regular workers. If an air traffic control specialist retires at age 50 with 20 years service under this new bill (as he could under the CSRS), his income replacement rate ranges from approximately 9.4% to 14.4% with full participation in the CAP. That is, if this worker paid out the 5.7% to Social Security and put another 10% away in the CAP, he'd get 14.4% of his income at retirement. The way this bill is set up, a controller would do far better leaving on disability than retiring. This would put a tremendous stress on the disability system. These employees have been put in a special category because we have found over the years that they need to retire earlier with fewer years of employment. It is in our best interest that they do so. The arbitrary changes you seek disregard what we have learned thus far.

There are some points regarding special category employees that do not appear to be addressed in the bill: a mandatory retirement age, and the ability to retire with 25 years of service at any age with a guaranteed annuity. We would hope that these points will be dealt with before the bill is released from committee.

While it is true that we are asking for several things, we are also willing to concede that some costs will have to be incurred by the employee. We believe that by requiring level contributions, that is, that each employee contributes 7% of pay minus the amount paid to Social Security, Federal employees will be able to have a satisfactory retirement plan. By adding up the changes incurred by our suggestions - 55/no reductions, full COLA, high-three salary base, changes in survivor and disability benefits, and the addition of level contributions - we can keep the thrift savings plan as it is (an even more important point if we stay with an add-on plan) and end up with a cost of approximately 25%, similar to the cost of the current system.

In conclusion, we must seek to provide the workforce with an adequate, stable income to maintain each person's standard of living. As we have said, a retirement plan is a form of deferred compensation. It is not a social welfare program. It aids in attracting and retaining a competent workforce. We have taken significant cuts in benefits over these last few years. An attractive retirement plan is about all we have left to entice people to come into government service. I would be happy to relate some of the experiences we, as managers, have had in attracting and retaining workers.

Finally, the current system offers some features that have proven to be important and valuable to the workforce. These features, such as retirement at 55 with 30 years service and unreduced benefits, calculating the benefit on the high three years of salary, and full cost-of-living adjustments, have been seen as steps forward in the design of retirement plans. Let's not move backwards by eliminating these features in the new plan. Much has been said about the high cost of our current retirement system. We seem to have lost sight of the fact that many of the retirement plans of the larger companies in this country are more generous than CSRS. We must ask ourselves whether we are seeking mediocrity or excellence in a retirement plan for Federal workers.